

Message Text

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TRSE-00 SS-15 STR-01 OMB-01 CEA-01 L-02 H-02 PA-01

PRS-01 USIA-06 CIAE-00 COME-00 EA-06 FRB-03 INR-07

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PASS CEA FOR GREENSPAN, TREAS FOR BENNETT AND WIDMAN,
FRB FOR SOLOMON, COMMERCE FOR PATE

E.O.11652: N/A

TAGS: ECON, OECD

SUBJECT: EPC MEETING, MARCH 6-7: GENERAL DISCUSSION AND
CONCLUSIONS

REFS: (A) USOECD 5833

(B) USOECD 5463

(C) USOECD 5350

(D) USOECD 4932

(E) USOECD 3914

(F) OECD DOC. CPE(75)2

(G) OECD DOC. CPE(75)3

1. SUMMARY: ECONOMIC POLICY COMMITTEE (EPC) FOCUSED
DISCUSSION ON ECONOMIES OF U.S., GERMANY, JAPAN AND UK --
A SIGNIFICANT DEPARTURE FROM USUAL BROAD TREATMENT OF
OECD COUNTRIES. COUNTRIES DIFFERED ON WHETHER BIG THREE
WERE STIMULATING THEIR ECONOMIES SUFFICIENTLY TO ACHIEVE
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SUSTAINED RECOVERY IN SECOND HALF 1975 AND BEYOND. U.S.,

JAPAN AND GERMANY NOTED MEASURES THEY HAD ALREADY TAKEN AND STRESSED DANGERS OF REKINDLING INFLATION, WHILE MOST OTHER COUNTRIES POINTED TO DECLINING INFLATION RATES AND RELATIVELY COMFORTABLE EXTERNAL POSITIONS OF BIG THREE AS JUSTIFYING LESS CAUTIOUS APPROACH TO REFLATION. BOTH LARGE AND SMALL DEFICIT COUNTRIES (IN VARYING DEGREES) EMPHASIZED THAT THEIR WEAK EXTERNAL POSITIONS AND HIGH INFLATION RATES MADE EXPORT-LED EXPANSION ESSENTIAL FOR RECOVERY OF DOMESTIC ACTIVITY. THEY URGED BIG THREE TO FOLLOW DETERMINED REFLATION PATH. EPC BRIEFLY DISCUSSED IMPLICATIONS OF BALANCE-OF-PAYMENTS SITUATIONS FOR DOMESTIC POLICIES, SIGNIFICANCE OF RECENT RELATIVE DEVALUATION OF DOLLAR EXCHANGE RATE AND PROJECTED LARGE SHARE OF SMALL COUNTRIES IN TOTAL OECD CURRENT ACCOUNT DEFICIT IN 1975. THESE QUESTIONS ALREADY COVERED IN MORE DETAIL IN WP-3 (REF A). EPC DELEGATES AND SECRETARIAT GENERALLY PLEASED WITH PROCEDURAL INNOVATIONS FOR THIS MEETING WHICH FOCUSED ON LARGE ECONOMIES AND GAVE RISE TO DEEPER EXAMINATION OF POLICY PROBLEMS AND OPTIONS THAN HAS BEEN ACHIEVED AT RECENT MEETINGS. NEXT MEETING OF EPC SCHEDULED TENTATIVELY FOR JUNE 16-17. END SUMMARY.

2. OUTLOOK FOR OECD ECONOMIES: GENERAL OUTLOOK IN EPC HAS NOT CHANGED SIGNIFICANTLY SINCE DISCUSSION AT SHORT-TERM FORECASTERS MEETING FEBRUARY 27-28 (REF B). PREVAILING VIEW IS THAT OECD COUNTRIES NOW IN MID-RECESSION AND CAN EXPECT FIRST HALF 1975 TO BE THIRD CONSECUTIVE HALF-YEAR OF DECLINING OUTPUT BEFORE MODEST RECOVERY IN SECOND HALF 1975. UNEMPLOYMENT FELT LIKELY TO INCREASE THROUGHOUT YEAR. THERE WERE DIFFERENCES IN JUDGMENT ON EXTENT OF LIKELY RECOVERY IN SECOND HALF OF 1975 AND ON WHETHER SUCH RECOVERY WAS LIKELY TO CONSTITUTE BEGINNING OF SUSTAINABLE UPSWING. MOST OPTIMISTIC NEWS IS THAT INFLATION NOW APPEARS TO BE RECEDING MARKEDLY IN MOST COUNTRIES DUE TO SLACK DEMAND, FALLING COMMODITY PRICES, REBATES ON RETAIL PRICES, AND GROWING RESTRAINT IN WAGE DEMANDS IN COUNTRIES WITH STRONGEST DEFLATION. BALANCE-OF-PAYMENTS OUTLOOK HAS IMPROVED FOR OECD AREA, WITH OVERALL CURRENT ACCOUNT DEFICIT SEEN DECLINING BELOW LIMITED OFFICIAL USE

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\$30 BILLION IN 1975, BUT DISTRIBUTION BETWEEN COUNTRIES IS VERY UNEVEN AND MAY BECOME MORE SO. LATEST MODIFICATIONS OF OECD FORECASTS FOR MAJOR SEVEN COUNTRIES REPORTED SEPTEL.

3. GENERAL POLICY ISSUES: MAIN QUESTION BEFORE EPC WAS WHETHER INFLATION HAS RECEDED SUFFICIENTLY IN U.S., GERMANY AND JAPAN TO PERMIT THEM TO FOLLOW MORE ACTIVE

ANTI-REFLATIONARY POLICIES THAN AT PRESENT. DELEGATES
OF THESE THREE COUNTRIES AGREED THAT RECENT RAPID DECLINE
IN INFLATION RATE IS FAVORABLE DEVELOPMENT WHICH IN-
CREASES FLEXIBILITY IN POLICY STANCE, BUT THEY REMAINED
CONVINCED THAT REFLATIONARY MEASURES SHOULD BE CAUTIOUS
AND GRADUAL TO AVOID DANGERS OF REKINDLING INFLATION AT
LATER DATE. OTHER LARGE COUNTRIES (UK, FRANCE, ITALY)
AND MOST SMALLER COUNTRIES BELIEVED THAT BIG THREE WERE

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BEING TOO CAUTIOUS IN FACE OF GROWING RECESSIONARY
DEVELOPMENTS IN THEIR ECONOMIES AND THEIR IMPACT ON
REST OF WORLD. THEY URGED BIG THREE
TO PROCEED TO TAKE MORE DETERMINED STIMULATORY MEASURES.
U.S. AND GERMANY NOTED EXPANSIONARY MEASURES ALREADY
TAKEN AND THEIR BELIEF THAT FURTHER ACTIONS SHOULD NOT
BE INSTITUTED BEFORE RESULTS OF RECENT POLICY CHANGES
HAVE BEEN OBSERVED. BOTH COUNTRIES EXPRESSED CONCERN
THAT EXCESSIVE USE OF FISCAL POLICY INSTRUMENTS WOULD

CREATE LARGE BUDGET DEFICITS WHICH WOULD BE DIFFICULT TO FINANCE WITHOUT CREATING UNDUE PRESSURE ON CAPITAL MARKETS (BY COMPETING WITH PRIVATE DEMAND FOR FUNDS) OR CAUSING EXCESSIVE EXPANSION OF MONETARY BASE. IN EITHER CASE, RESULTS WOULD BE CONTRARY TO OBJECTIVE OF SUSTAINING ECONOMIC ACTIVITY WITHOUT REKINDLING INFLATION. JAPAN NOTED THAT IT HAS ALREADY TAKEN CERTAIN UNANNOUNCED MEASURES IN ATTEMPT TO SLOW DOWN DECLINE IN ECONOMIC ACTIVITY, BUT IT CANNOT TAKE HIGHLY VISIBLE STEPS TOWARDS REFLATION BEFORE SPRING WAGE BARGAINING ROUND IS LIMITED OFFICIAL USE

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CONCLUDED. JAPANESE DO NOT BELIEVE THAT INFLATION PSYCHOLOGY HAS YET BEEN BROKEN IN JAPAN, AND THEY ARE EXTREMELY HESITANT TO INTRODUCE MAJOR CHANGES IN POLICY DIRECTION.

4. BALANCE OF PAYMENTS: EPC HEARD REPORT ON RESULTS OF MARCH 5 WP-3 (REF A), AND HELD BRIEF EXCHANGE ON SOME OF ISSUES ALREADY COVERED IN MORE DETAIL BY WP-3. EPC AGREED IN GENERAL THAT IT WOULD BE MOST APPROPRIATE FOR COUNTRIES IN SURPLUS OR NEAR EQUILIBRIUM ON CURRENT ACCOUNT TO TAKE LEAD IN REFLATING THEIR ECONOMIES, WHILE DEFICIT COUNTRIES SHOULD CONCENTRATE ON CONTROL OF DOMESTIC INFLATION AND WAIT FOR EXTERNAL STIMULUS THROUGH TRADE ACCOUNT. JAPAN SPECIFICALLY STATED THAT ITS DOMESTIC POLICIES WOULD NOT BE INFLUENCED BY CONSIDERATIONS OF EXTERNAL BALANCE.

5. FISCAL POLICY: U.S. (GREENSPAN) INITIATED DISCUSSION ON LIMITS OF FISCAL POLICY AS REFLATIONARY DEVICE. EXCESSIVE USE OF FISCAL POLICY COULD BE COUNTERPRODUCTIVE IF IT CREATED LARGE BUDGET DEFICITS WHOSE FINANCING PLACED EXCESSIVE STRAIN ON CAPITAL MARKETS AND REQUIRED LARGE EXPANSION OF MONETARY AGGREGATES. U.S. DID NOT EXPECT THIS TO HAPPEN IN 1975, SINCE DECLINING PRIVATE DEMANDS FOR CAPITAL WOULD LEAVE VACUUM FOR TREASURY ISSUES TO FILL, BUT CONTINUATION OF DEFICITS INTO 1976 WOULD COINCIDE WITH RECOVERY AND MIGHT GIVE NEW IMPETUS TO ANOTHER ROUND OF INFLATION. GERMANY AND JAPAN STRONGLY SUPPORTED U.S. VIEW, WHILE SECRETARIAT REPLIED THAT THIS WAS GOOD REASON TO MAKE FISCAL POLICY ACTIONS PROMPT AND EASILY REVERSIBLE. ITALY NOTED THAT CROWDING OUT EFFECT IN CAPITAL MARKETS WAS FUNCTION OF DEGREE OF SLACK IN ECONOMY, AND SUPPORTED SECRETARIAT ON NEED FOR LARGE BUT REVERSIBLE FISCAL STIMULUS. SMALL COUNTRIES TOOK GENERAL VIEW THAT CONCERN OVER EFFECTS OF FISCAL POLICY ON INFLATION IN EIGHTEEN MONTHS TIME WAS NOT AS URGENT AS NEED FOR IMMEDIATE REFLATIONARY MEASURES TO COMBAT RECESSION.

6. CONSUMER CONFIDENCE: EPC ALSO SOUGHT TO IDENTIFY FACTORS AFFECTING CONSUMER AND BUSINESS CONFIDENCE. U.S. LIMITED OFFICIAL USE

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(GREENSPAN) THOUGHT THAT REDUCTION OF INFLATION RATE WAS KEY TO RESUMPTION OF CONFIDENCE BECAUSE CONSISTENT INFLATIONARY EXPECTATIONS CAUSE HOUSEHOLDS TO MAINTAIN HIGH PRECAUTIONARY BALANCES AND REDUCE DISCRETIONARY EXPENDITURES ON LARGE ITEMS. REDUCTION OF INFLATION WOULD THEREFORE CONTRIBUTE TO RECOVERY OF CONSUMER DEMAND. OTHER DELS SUGGESTED THAT REDUCTION IN CONSUMER DEMAND MIGHT BE REFLECTION OF DECLINE IN REAL WAGES, AND THAT HIGH SAVINGS RATIOS MIGHT REFLECT POOR OUTLOOK FOR EMPLOYMENT. U.S. DEL AGREED THAT DECLINE IN RATE OF INCREASE IN UNEMPLOYMENT WOULD HAVE SIGNIFICANT IMPACT ON CONSUMER CONFIDENCE, AND HE EXPECTED SUCH DECLINE WOULD IN FACT CONTRIBUTE TO RECOVERY OF U.S. CONSUMER DEMAND IN SECOND HALF OF 1975.

7. WP-2 REPORT ON ENERGY: EPC TOOK EXCEPTION TO CONCLUSION IN WP-2 REPORT ON MACRO-ECONOMIC IMPACT OF HIGHER ENERGY PRICES (REF G) THAT CHANGES IN RELATIVE PRICES OF ENERGY ARE HAVING ONLY RELATIVELY SMALL IMPACT ON POTENTIAL GROWTH OF OECD COUNTRIES AND THAT THIS EFFECT WILL BE DISSIPATED OVER TIME. JAPAN, CANADA AND U.S. ALL DOUBTED THIS CONCLUSION HAD BEEN BASED ON SUFFICIENT ANALYSIS AND SUGGESTED THAT THIS PROBLEM NEEDED FURTHER EXAMINATION AT MICRO-ECONOMIC LEVEL.

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8. PROCEDURAL INNOVATIONS: NEW EPC FORMAT INVOLVING CONCENTRATION ON LARGER ECONOMIES AND PROVISION FOR QUESTIONS BY "EXAMINING COUNTRIES" CONTRIBUTED TO DEEPER LEVEL OF ANALYSIS THAN HAS HITHERTO BEEN POSSIBLE IN EPC. IT AVOIDED TRADITIONAL "MULTILATERAL MONOLOGUES" OF PAST MEETINGS, AND APPEARED TO HAVE BEEN ACCEPTABLE TO SMALLER COUNTRIES WHOSE OPPORTUNITIES FOR EXPRESSION WERE MOST SEVERELY CURTAILED. CHAIRMAN SIR DOUGLAS ALLEN HELD FIRM CONTROL OVER MEETING AND INVITED DELEGATES TO CONSIDER CONTINUATION OF THIS FORMAT FOR FUTURE MEETINGS. HE SUGGESTED THAT BESIDES BIG THREE AND UK, OTHER COUNTRIES MIGHT BE EXAMINED AT NEXT MEETING (E.G. FRANCE, ITALY, CANADA), AND MORE ATTENTION MIGHT BE GIVEN TO BALANCE-OF-PAYMENTS EFFECTS ON SMALLER COUNTRIES AND LDC'S. GENERAL VIEW OF SECRETARIAT AND DELEGATES TOWARDS NEW PROCEDURE HAS BEEN VERY FAVORABLE.

9. NEXT MEETING OF EPC TENTATIVELY SCHEDULED FOR JUNE
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16-17. CHAIRMAN REQUESTS THAT DELEGATES CONSIDER CANDIDACY FOR CHAIRMANSHIP OF WP-4, WHICH REMAINS OPEN AFTER SLATER OF CANADA ANNOUNCED HIS INABILITY TO CONTINUE ON PERMANENT BASIS.

10. VIEWS EXPRESS BY BIG THREE AND OTHER INDIVIDUAL COUNTRIES AT EPC MEETING FOLLOW BY SEPT. TURNER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MEETING REPORTS, COMMITTEE MEETINGS, ECONOMIC PROGRAMS, ECONOMIC TRENDS
Control Number: n/a
Copy: SINGLE
Draft Date: 12 MAR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: MorefiRH
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975OECDP06299
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750086-0619
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Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750358/aaaacagt.tel
Line Count: 326
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
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Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
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Reference: 75 USOECD 5833
Review Action: RELEASED, APPROVED
Review Authority: MorefiRH
Review Comment: n/a
Review Content Flags:
Review Date: 13 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <13 MAY 2003 by ElyME>; APPROVED <19 MAY 2003 by MorefiRH>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EPC MEETING, MARCH 6-7: GENERAL DISCUSSION AND CONCLUSIONS
TAGS: ECON, OECD
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006